No. 14,400

In the

United States Court of Appeals

For the Ninth Circuit

1954 Term

United Producers and Consumers Co-Operative, a Corporation, and Southwest Co-Operative Wholesale, a Corporation,

Appellants,

vs.

Ralph W. Held,

Appellee.

Appellee's Reply Brief

Appeal from the United States District Court
for the District of Arizona

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STATEMENT OF CASE

Although the two corporate defendants are separate non-profit corporations, they are, for operating purposes, almost identical. The Southwest Co-Operative Wholesale, is a corporation, the principal customer of which is the United Producers and Consumers Co-operative (TR 144). The United Producers and Consumers Co-Operative in turn sells to retail customers. The personnel operating the two are

the same; the location of their offices is the same; several of the incorporators of each are the same; and several of the officers and directors, including the president, are likewise the same. Both of them, however, were not, as stated in the Appellants' Brief, organized in accordance with Chapter 49, Article 7, Arizona Code Annotated, 1939, which is the Chapter entitled "Cooperative Marketing". The United was organized pursuant to this chapter and it is so stated in the preamble. The Southwest was not, and could not be, because it is a stock corporation, which a cooperative marketing corporation may not be under the Arizona Code (Section 49-701, Arizona Code Annotated, 1939). The Southwest was organized under the general incorporation laws.

In December, 1951, the two corporations were badly in need of a General Manager. At that time one of the directors wrote a letter to Ralph Held, the plaintiff, in Des Moines, Iowa, where he was a co-op executive, seeking to find a manager (TR 58). In January, 1952, the same director arranged a meeting in Chicago between Plaintiff and Mr. Walter Smith, President of both corporations, and Mr. Lewis Walmsley, auditor for both corporations (TR 59). The Defendants' representatives were sufficiently impressed with the Plaintiff that as a result of the meeting Mr. Smith offered to pay the expenses of the plaintiff if he would go to Phoenix and look the situation over. The plaintiff did so and spent two days in Phoenix being entertained by members of the defendants' organizations and consulting, advising and inspecting (TR 62-64). Plaintiff at that time told Mr. Smith he was not interested in any offer to become manager (TR 65). Later in February, 1952, Mr. Smith telephoned the plaintiff in Des Moines and again importuned him to go to Phoenix. At that time the plaintiff told Mr. Smith he was practically committed to accept a

position in St. Louis, but Smith insisted and again offered to pay plaintiff's expenses to go to Phoenix and take a second look at defendants' proposition (TR 66). Plaintiff finally agreed to do so and again spent a couple of days in Phoenix. He was met by Mr. Smith and taken to a luncheon attended by a number of the directors. Later that afternoon he attended a formal meeting of the combined boards of directors of both corporations and interviewed them and was interviewed. At that time he told the directors that he would not consider employment for less than a three year term (TR 68). Following the interview plaintiff was excused and the boards considered the matter. Mr. Smith, the President, then came out and told plaintiff the boards had given him authority to employ the plaintiff (TR 69). Smith arranged a dinner engagement for plaintiff with Mr. Walmsley, the auditor, on the same evening, during which the employment terms were further discussed. The following afternoon a written contract was dictated by plaintiff and Smith together and prepared in triplicate (TR 72; 108). Smith signed two copies and gave them to plaintiff who stated he would consider this offer and the St. Louis offer further and let Mr. Smith know his decision. On March 20, 1952, Smith again telephoned the plaintiff in Des Moines to learn what the plaintiff's decision had been and at that time the plaintiff told Smith he would accept, and would place the signed contract in the mail (TR 74). He did so and the contract was received. President Smith died suddenly on March 25, 1952 and the plaintiff went to Phoenix and assumed management of both corporations on April 1, 1952. He devoted all of his time to the business of the two corporations and attended all of the meetings of the boards of directors, of which there were three or four, prior to the time the present difficulty arose.

On May 27, 1952, while the plaintiff was in Des Moines to bring his family to Phoenix after having sold his house there, he received a telegram from D. O. Essley, the new president, questioning the legality of his contract. This was the first suggestion he had received that anything was wrong. He returned to Phoenix to confer with the boards and later learned that the claimed illegality was that the boards' resolution authorizing his employment had stated the boards had authorized Smith and Walmsley to work out the terms of his employment and Walmsley had stated he had not been consulted by Smith. No notice was ever given the plaintiff that such was the tenor of the resolution or that Smith did not have complete authority (TR 352). The plaintiff's contract was formally terminated on June 20, 1952, and he was so notified. This action ensued.

ARGUMENT

I.

A Manager's Contract for a Three Year Term Is Not Prohibited by the By-Laws of the Defendant Corporations.

It is to be noted that the By-Laws of neither corporation say that the Board is "prohibited" from employing a manager for a definite term even though Appellants' First Proposition of Law is thus stated. The By-Laws of both corporations do state that the board of directors shall have power to appoint a manager, "who shall hold office at the pleasure of and upon terms and conditions fixed by the Board." The By-laws of United, however, also contain a provision which refers to both appointive and elected offices and states:

> "Article VIII, Sec. 3. The compensation and *tenure of office* of all offices shall be fixed by the Board of Directors."

It is therefore concluded by Appellants that the provision for holding office "at the pleasure" of the board gives the board the power to arbitrarily discharge a manager employed by a written contract for a term of three years. Let us examine the argument in the light of the facts as they are shown to have existed. When Mr. Held met with the directors of the two corporations on March 6, 1952 he had gone to Phoenix at their express invitation and expense to consider the managership. It was the second trip he had made at the defendant corporations' invitation and expense, the offer to negotiate having been turned down by plaintiff on the first occasion. The President of both corporations had personally negotiated with him on several previous occasions and this instance. Several members of the boards had met with him and talked with him on the very day of the formal meeting. They knew he was there for the purpose of discussing an employment contract. The members of the boards knew that their By-Laws provided that they had the power to employ a manager "at their pleasure." Mr. Held, the prospective manager, said to them at that meeting (TR 68):

> "Q. What discussion did you have at that meeting with the members of the Board? Did they make any inquiries of you, and tell the Court what those were?
>
> A. Yes, they invited me into the meeting and asked me to relate my business experience which I had, which covered the period of management of the two co-operatives back in Iowa which I had previously managed and I think I went back to the time that I graduated from Iowa State College and spent 4 years as a county agricultural agent in one of the northwest Iowa counties and then spent 4 years as a farm loan representative for the farm loan division of the Aetna Life Insurance Company, after which I spent all of my time in co-operative management.

I believe I also told them that while I was here interested in their proposition that I was tentatively committed, at least I felt that I was, on a job in St. Louis with a corporation with which I had been familiar for some time, and that they were offering me a job at $10,000 per year and that under the circumstances I couldn't consider coming out here for less than a 3 year term.

Q. Did any of the members of the Board of (20) Directors make any objection to your statement that you wouldn't consider coming out here for anything less than a 3-year term?

A. Not that I was aware of.

Q. Did any of them say anything at that time?

A. No, sir."

The members of the Board thereupon retired to executive session and authorized the negotiation of a contract of employment after discussion of a three year term with no objections having been made, and such a contract was actually executed (TR 146). Can it not fairly be said that the three year term did in fact represent their pleasure? It is, of course, true that had the plaintiff accepted employment without a definite term he would have been subject to arbitrary discharge "at their pleasure", but when the period of employment was discussed in advance and a formal contract was thereafter executed in accordance with that discussion and the plaintiff worked under it with the knowledge and acquiescence of the boards, it would appear basic honesty would require its legal approval unless overpowering reasons compelled its rejection.

Upon authority, appellants have cited cases from several jurisdictions apparently sustaining the right to discharge an officer notwithstanding a definite term. The cases cited at pages 17-18 of Appellants' Brief are principally from

ew Jersey, West Virginia and Washington. In each of ıose cases the deciding factor was a state statute. Arizona as no similar statute as Appellants concede on page 24 of ıeir brief. The Federal case cited (*Wright v. Warren Bros. o.*, 204 Fed. 231) was one which arose in West Virginia nd was likewise based upon a West Virginia statute. The owa case cited on page 18 (*Selley v. American Lubricator o.*, 119 Iowa 591, 93 NW 590) was a case of discharge for ause and thus not in point. The New York case (*Douglass Merchants Ins. Co.*, 118 N.Y. 484, 23 NE 806) was one here the plaintiff had been an employee of a corporation or some 28 years and there was *no* special contract as to erm of service. The court stated that the "at the pleasure" rovision of the By-Laws constituted a "reserved right of ermination" at the time the plaintiff was employed. The ourt further indicated that where there was a special con- act of employment the case might be different. The Court pproved an earlier Superior Court case holding to the ontra and establishing liability of the corporation where ıere was a special contract and stated at page 807:

> "It may be assumed, for the purposes of the question, that this is within the power of the board, which creates the by-laws, and that when it appears that a special contract is made by such board, in terms which indicate an intent of the parties to exclude from it the operation of the by-laws having relation to the right of terminating service, such contract of employment may not be subject to it."

The court thereafter continued and stated at page 807:

> "But here was no special contract which indicated any purpose to abridge the right of removal at pleasure given by the by-law, which entered into the contract of employment, and subject to which the plaintiff went into, and continued in, the defendant's service until this reserved power was exercised."

It is respectfully submitted that the cases relied upon by Appellants do not represent the best of the law either upon principle or upon authority. In Fletcher, Cyclopedia of Corporations (Permanent Edition) Volume 2 of the 1954 Revised Volume, the author discusses this problem and concludes:

> "* * * on the other hand, the trend of recent authority seems to be in favor of recognizing liability on the part of the corporation." (Para. 355, page 158.)

In 19 C.J.S. Par. 738 (3) page 72, it is stated:

> "An agent employed under a contract fixing no stated term of employment may be removed even in the absence of any by-law so providing; but a corporation cannot, without cause, discharge or remove an agent in violation of a contract under which he is employed for a definite period without becoming liable for damages, *despite a statute or by-law permitting the removal of agents at the pleasure of the board.* * * *" (Emphasis added.)

Later New York cases have held that despite a by-law and even in the face of a state statute, which gives the directors the power to remove an officer, agent or employee "at pleasure" (Sec. 60, N. Y. Stock Corp. Law) this right of removal is subject to liability for damages if wrongfully exercised where there is a special contract.

See: *Cuppy v. Stollwerck Bros.*, 216 N. Y. 591, 111 NE 249 (1916);

In Re: Paramount Publix Corporation, 90 Fed. 2d 441-444 (2nd Cir. 1937).

In the latter case, which was an appeal from the District Court of the United States for the Southern District of New York, the question was one of the validity of an employ-

ment contract for three years in view of the New York statute, providing in part:

> "The Directors may require any such officer, agent or employee to give security for the faithful performance of his duties, and may remove him at pleasure." (Sec. 60, N. Y. Stock Corp. Law.)

Judge Swan pointed out that the District Court had held that a corporation is liable in damages for discharging an employee without cause prior to the termination of his contract even under this statute and concluded (Page 433):

> "The consequences of accepting the opposite view are startling. It would mean that no New York stock corporation could make a binding contract of employment for a definite term; all officers, agents and employees would be dischargeable at will without liability on the part of the corporation, and it would follow that any of them could leave at will without incurring liability on their part, no matter how essential their services might be to the interests of the corporation. The announcement of such a doctrine would certainly cause surprise and consternation to the business world, for the statute has stood on the books since 1890 without any court decision to that effect and it is common knowledge that many contracts of term employment have been made by New York corporations on the assumption of their validity."

Judge Swan then analyzed the New York cases and also considered the cases from West Virginia and Washington and stated (Page 445):

> "There would seem to be no more reason to hold that section 60 was intended to relieve the corporation from the obligation to pay damages for breach of contract than to construe in that way a by-law empowering the directors to remove an officer at pleasure. Such a by-law came before the Court of Appeals in Cuppy v.

Stollwerck Bros., 216 N. Y. 591, at page 597, 111 N.E. 249, 250, where the court said:

"'The power to remove him from the office to which he had been elected did not carry with it the right to discharge him from the employment of the defendant in view of the special contract for a fixed term under which he was employed'".

Appellee respectfully submits that the decision of this distinguished court is entirely sound.

Cases which have held that a corporation is liable for wrongful discharge despite a provision in their by-laws similar to those under consideration here are as follows:

Realty Acceptance Corporation v. Montgomery, 51 Fed. 2d 636, 639 (3rd Cir. 1930);

Hill v. American Cooperative Assoc., 195 La. 590; 197 So. 241 (1940);

Nelson v. James Nelson & Sons, 2 KB 471 (1913);

Trustees v. Shaffer, 63 Ill. 243.

In the latter cases the courts have pointed out that by-laws are nothing more than rules of conduct adopted by the directors or the members themselves for the efficient handling of the business affairs of the corporation and are subject to amendment. Where the board either directly or through its duly authorized agent enters into a contract for a definite term it cannot escape responsibility for this contract and repudiate it by taking refuge behind a by-law which the corporation could have amended or modified.

The by-laws of both of the defendant corporations are subject to amendment.

The by-laws of United Producers and Consumers Co-Operative are as follows:

"Article XIV. * * * The By-laws may be amended, altered or repealed by the Board of Directors at any regular or special meeting."

The By-laws of Southwest Co-Operative Wholesale are as follows:

> "Article VIII. Amendments. These by-laws may be amended by the majority vote of the directors of the corporation at any meeting called for that purpose except as limited in the Articles of Incorporation or by law."

Appellants argue there is some statutory restriction on the right to amend because of the provision of the Co-Operative Marketing Act of the State of Arizona. This is incorrect. In the first place the Southwest was not organized pursuant to that act and cannot qualify under it because it is a stock corporation. Its power to amend is limited only by its own by-laws. Secondly, there is no evidence of any limitation upon the power of United Producers and Consumers Co-Operative by way of restriction to amendments to "contract period" as contended on page 21 of Appellants' brief. At that page in their brief Appellants stated that the by-laws of United can only be revised or renewed at the end of each contract period and the contract period was one year from March 1, 1952. This statement refers to a provision of the Act which provides that:

> "The association and its members may make and execute marketing contracts, requiring the members to sell, for any period of time, not over ten [10] years, all or any specified part of their agricultural products, or specified commodities, exclusively to or through the association or its facilities; * * *" (Section 49-713, Arizona Code Annotated, 1939)

This is a *marketing contract* wherein the members for a term agree to sell certain or all of their products to the co-operative during the contract period. The provision that the by-laws cannot be revised or renewed except at the end

of the contract period was undoubtedly to protect the members against a change in price or terms during that interval. There is absolutely no evidence United had any such contract with any of its members. The statute is permissive only. The contract referred to at page 191-192 of the Record which is relied upon by Appellants is an entirely different matter. That was simply a resolution and not a contract, passed at the instance of the auditor at the beginning of each year, which provides that the net savings for the year should be credited to the patrons. It was a tax saving device and not a marketing contract with members to sell their products to the company. It imposed no limitation on the right to amend. There was, therefore, no limitation upon the power to amend the by-laws by United and the Assistant Secretary testified that they were *in fact amended* from time to time in regular meetings (RT 329). Moreover, the by-laws of United did not require amendment because they expressly provided that the compensation and *tenure of office* of all offices should be fixed by the Board of Directors (Art. VIII, Sec. 3).

It should be noted apropos of the Washington cases relied upon by Appellants which are based upon a statute, that the Legislature thought so little of the public policy permitting a corporation to enter into a contract for a term and then repudiate it without responsibility that it amended the law and made a corporation responsible for such breach of contract.

See: *Hansen v. Columbia Breweries, Inc.,* 12 Wash. 2d 554, 122 P.2d 489 (1942).

Similarly, the clause in the West Virginia statute which provided that "officers and agents shall hold their places during the pleasure of the board" (W. Va. Code Ann. 1923

C53, Para. 53) which was the basis for the cases from that state relied upon by Appellants, was *deleted* in the revision of 1931 (W. Va. Code Ann. 1932, Para. 3030) and has been omitted in all subsequent revisions.

The Model Business Corporation Act prepared by the National Conference of Commissioners on Uniform State Laws and enacted by several state legislatures is in accord in providing that corporations should have the power to remove but shall be liable in damages for wrongful removal (Sec. 32, Par. IV).

II.

A Contract for Employment of a Manager for a Corporation for a Term Beyond the Terms of the Then Members of the Board Is Not Void or Unenforceable.

This proposition of law has never been passed upon by the courts of Arizona. Appellants cite the Arizona case of *Tucson Federal Savings & Loan Ass'n v. Aetna Inv. Corp.*, 74 Ariz. 163, 245 P.2d 423 (1952), as authority for their position that such a contract is void. That case was one where the legality of a 10 year contract by one corporation to sell insurance to another corporation was in question. The Savings and Loan Association in its attempt to avoid the contract, cited certain employment cases as its authority. The Supreme Court of Arizona properly pointed out those cases were not in point and stated at page 170 of the Official Reporter:

> "These cases limit the application of the rule to employment contracts, which we believe is sound."

The Court held the contract in fact to be a binding contract and allowed damages for failure of all parties to perform it. The issue of the validity of an employment contract was not even before the Court. The statement quoted would

seem to say that employment cases are not in point on the issue before the Arizona Court. In fact, the employment cases cited by the Arizona Court were Texas cases dependent upon statute, a Wisconsin case involving a contract for life and a Louisiana case involving a secret contract between a President and a third party without the knowledge of the board of directors. The issue before the court here was never presented to the Arizona Courts, and has not been passed upon.

Appellants rely upon two cases from Texas and Washington as supporting their view that a contract for a term beyond the term of the board is against public policy as limiting future action. Appellants were forced to concede, however, those cases were dependant upon statute and no such statute existed in Arizona (R. p. 24). Moreover, the Washington cases have been over-ruled by the later case of *Hansen v. Columbia Breweries, Inc.* supra, wherein the Supreme Court of Washington said positively:

> "* * * After entering into contracts of employment for a fixed period of time, corporations must be held liable in damages for the violation of such contract.
>
> "The argument that the employment of agents or employees for a term of years deprives succeeding trustees of the power of removal and perpetuates a business policy is not persuasive. We are unable to see that the construction of the statute in a manner that permits the board of trustees to bind a corporation for a fixed term by employing individuals for a definite time handicaps the succeeding board any more than does the admitted power to bind the corporation by long term leases or other kinds of contracts extending over a long period of years."

The language quoted above appears to have been taken from an almost identical statement made by the Circuit

Court for the Second Circuit in the *In Re: Paramount Publix Corp.* case, supra. As a practical matter it may well happen frequently that it is impossible for a corporation to hire a man of ability unless it does have the power to bind itself for a definite term. The public policy therefore should seem to be favorable to the legality of such a contract and not unfavorable. Moreover, in this case the terms of the members of the boards were in fact for three years each, although a portion was elected each year and their terms thus staggered. The evidence also showed although they were elected, their election and re-election was a matter of course. Practically all of the members had served successive terms from date of incorporation to either their death or retirement (RT 142-143).

The cases which Appellee has cited hold that in the absence of a state statute (and Arizona has none) there is no public policy prohibiting the execution of a contract of employment by the board of directors beyond the term of office of the existing board. As stated by the Court for the Third Circuit in considering the five year employment contract involved there (p. 639):

> "Nor was the contract one against public policy. It was not tainted with fraud. The restraint thereby placed upon the future freedom of action of defendant's board of directors cannot be said to have been in fact or principle injurious to the public interest. The term of office therein fixed was neither permanent, unlimited nor for life, but, in view of plaintiff's relation to defendant and his familiarity and grasp of its business, was for a reasonable period only. The contract was in conflict with no statute. * * *" (*Realty Acceptance Corp. v. Montgomery,* 51 F2 636, 639.)

III and IV.

The Plaintiff Was Employed Pursuant to the Boards' Authority.

The Third and Fourth propositions of law advanced by Appellants concern the agency questions which have been raised. In those propositions Appellants challenge the authority of President Smith to bind the corporations on the contract. In answer, Appellee will combine his argument under one heading since the issue is a single one, namely, the liability of the two corporations for the contract executed by Smith.

The Appellants, in their Third proposition, contend that because the uncommunicated and private resolution of the corporations authorized both Smith and Walmsley to "employ Mr. Held as general manager and work out the terms of his employment", a contract signed by Smith alone is invalid. It should be noted that the resolution does not require both men to sign the contract and unless Held had been expressly notified he would not expect, in the ordinary course of affairs, that an employment contract for a manager for a three year period would require the signature of an auditor.

There is not one iota of testimony that Held, prior to or at the time he began work, was notified of the resolution (TR 99). He testified that he did not know and that he had not the slightest inkling that Smith did not have complete authority to sign the contract (TR 352). Even if Held had been present at a later meeting of the boards and had heard the resolution read, there was nothing to indicate to him that Walmsley had not conferred with Smith and approved the contract as the resolution provided. He had ample opportunity to do so. The contract was signed by Smith on March 7, 1952. Held did not sign and return his copy until March 20, 1952. He did not report for work until April 1, 1952. In the meantime, both the resolution and the contract were a

part of the official files of the corporations and accessible to Walmsley and any other member of the boards (TR 153).

The suggestion in Appellants' brief that Held was in any way over-reaching in his negotiations or attempting to force an agreement for a contract, is entirely contrary to the actual evidence in the record. He had not solicited this employment. Smith and the other directors had solicited him and had kept after him even after he had, upon the first occasion, notified the corporations that he was not interested. At the time he had a good position in Des Moines, Iowa, and had been offered a better position in St. Louis. He had not the slightest reason to avoid Walmsley and as a matter of fact the testimony shows that he did not. On the very day that the resolution was adopted authorizing Held's employment, Mr. Smith, the president, requested Walmsley to take Mr. Held to dinner at the Arizona Club (TR 170). At this meeting the terms of the employment were discussed with Walmsley (TR 170) and Walmsley indicated no objection to any of the terms which had theretofore been discussed. From Held's point of view he had every reason to believe that both Walmsley and Smith were co-operating completely in the negotiations, even though there was no reason for him to believe that Walmsley's signature was required on the document.

Nor is there anything in the resolution itself that in fact requires Walmsley's signature on the document. From Held's standpoint so far as can be told from the record, both Smith and Walmsley did "work out the terms of his employment."

There is substantial evidence, moreover, from which the court could have found and did find that Smith and Smith alone was the one whom the boards of directors empowered to make the final decision on the contract, and that Walmsley was authorized only for the purpose of advising and

assisting Smith. Orval Knox, who was an officer and director of one of the companies and who was present at the meeting when the resolution was adopted, so testified (TR 148). The trial court has found as a fact upon this and the other evidence that the approval of Walmsley was not required to authorize or validate the contract (TR 30, Finding of Fact V).

Not only was there actual authority, but, it is submitted there could not be a more clear cut case of apparent authority of Smith to negotiate and execute the contract. The President is the one who normally would execute such a contract and negotiate it. The Boards of directors were entirely aware at all times that Smith was in the course of negotiating the contract. They held him out to the plaintiff as having that authority. Not only did they fail to notify Held that there were secret limitations upon the authority of Smith, but they did not even notify their own employee that he was expected to have a part in the negotiations. The general rule with respect to apparent authority is set out in 13 American Jurisprudence, Para. 890, at page 870, as follows:

> "It is a fundamental and well-settled rule that when, in the usual course of the business of a corporation an officer or other agent is held out by the corporation or has been permitted to act for it or manage its affairs in such a way as to justify third persons who deal with him in inferring or assuming that he is doing an act or making a contract within the scope of his authority, the corporation is bound thereby, even though such officer or agent has not the actual authority from the corporation to do such an act or make such a contract. This authority is known as apparent or ostensible authority. This apparent authority is materially the same and is based upon the same principles as authority by estoppel. Stating the rule in terms of estoppel,

> a corporation which, by its voluntary act, places an officer or agent in such a position or situation that persons of ordinary prudence, conversant with business usages and the nature of the particular business, are justified in assuming that he has authority to perform the act in question and deal with him upon that assumption is estopped as against such persons from denying the officer's or agent's authority."

It is supported by a multiude of cases and is the rule adopted by the American Law Institute in its Restatement on Agency.

But, argue the Appellants, they also desired Walmsley to participate and now assert that where the agency is conferred on two or more persons they must act accordingly. Even if conceded that the general rule is as asserted, nevertheless insofar as Held is concerned, it would appear they did in fact act jointly. Walmsley testified that he did not know anything about this authority that was conferred upon him. However, Mr. Collier, one of the directors, testified *he told Walmsley about it* on/about March 7, 1952, the date the authority was conferred (TR 219).

Pauline McInerney, the Assistant Secretary, also knew about it because she typed out the resolution (TR 329). But not a one of the defendants' directors or officers or agents testified that any of them had notified Held. Under such circumstances Held surely could not be bound by whatever secret limitations the directors saw fit to place upon the authority if there were in fact such limitations made. It is submitted that neither the facts nor the law sustain Appellants' argument on this proposition.

> "As to third persons dealing in good faith with an officer or an agent of a corporation and relying upon his apparent authority, such authority is tantamount to the actual authority of the agent. Secret instructions

or limitations upon the apparent general authority of an officer or agent of a corporation will not affect one who deals with him in the general line of his authority, who knows nothing of such limitations. This is an exception to the rule that one dealing with the officer or agent of a corporation is bound to ascertain the extent of his authority. * * *" (13 Am. Jur. Para. 982, p. 872.)

See also: *Wayne v. New York Life Ins. Co.,* 132 F.2d 28 (8th Cir. 1943).

In the *Wayne* case, supra, Judge Gardiner said at page 33: "* * * Where a principal clothes its agent with apparent authority to act in certain capacity, it is bound by all the acts of such agent within the scope of such authority. Third persons dealing with an agent possessing such authority are not bound by secret limitations on such apparent authority."

Appellee does not question the authority of the Arizona cases cited under proposition IV to the effect that a person dealing with an agent has a duty to ascertain the agent's authority. They are entirely sound as applied to their own facts. But the Arizona court recognizes that as a counterpart of the third person's duty to use reasonable care to ascertain the agent's authority, the principal has likewise some responsibility where it holds out its officer or agent to that third party as being its authorized representative. And if the third party has acted reasonably under the circumstances in assuming the agent to have had the authority which he purported to have, the principal is bound. Said the Arizona court in the case of *Lois Grunow Memorial Clinic v. Davis,* 49 Ariz. 277, 66 P.2d 238, at page 242:

"The authority of an agent may be either direct or implied. Direct authority exists only when the principal

has definitely and specifically authorized the agent to perform the act in question, but when the rights of third persons are concerned, the law sometimes implies the authority of the agent, although no direct authority has been given the latter, and in some circumstances even though the authority has been expressly refused by the principal. The test in cases where implied authority is relied upon is whether, *under all the circumstances of the particular case,* the party relying on such authority acted as a reasonable and prudent man who knows that he is dealing with an agent, in ascertaining the extent of the authority of that agent. * * *" (Emphasis by the Court.)

In this case the court, after hearing the evidence, was of the view, and properly so, that Held was abundantly justified in assuming that President Smith had the authority he purported to exercise.

V.

Ratification

Appellants contend there could be no ratification of this employment contract because the directors had no knowledge of it. Yet the directors had sat in a special formal meeting on March 6, 1952 and authorized the employment of Held as manager. On April 3, 1952, Held attended a meeting as manager and assumed his duties. He was there for almost three months and attended three or four directors' meetings. It is somewhat of a strain on one's credulity to believe that the directors did not have some idea that Held was employed and there was a contract of employment. Smith, the President of both, and a director of both, knew about the contract prior to his death. Orval Knox, an officer and director of Southwest knew about it. Pauline McInerney, Assistant Secretary, drew up the contract, saw Smith sign it and opened

up the letter containing the contract when it was sent back by Held. It is reasonable to believe that others of the directors knew about it also.

> "It is not necessary in order to show knowledge of a corporation to show knowledge by its Board of Directors; it is sufficient to show knowledge by any officer or agent obtained while performing business for the corporation within the scope of his authority." (3 Fletcher Cyclopedia Corporations (permanent edition) Para. 807, p. 59.)

See also: *13 Am. Jur. 1036;*
Weathersby v. Texas & Ohio Lumber Co., 107 Tex. 474, 180 SW 735 (1915).

A corporation may ratify an act simply by failure to repudiate it after knowledge, whether actual or implied.

See: *13 Am. Jur. Para. 983, p. 935;*
Baltimore & O. R. Co. v. Foar, 84 F.2d 67 (7th Cir. 1936).

In the latter case the court said at page 71:

> "A board of directors is not only bound by what it actually knows, but it may be bound by what it ought to have known, or by proper attention to its business would have known. In Knights of Pythias v. Kalinski, 163 U.S. 289, 16 S.Ct. 1047, 1051, 41 L.Ed. 163, the Court said, 'If the company ought to have known of the facts, or, with proper attention to its own business, would have been apprised of them, it has no right to set up its ignorance as an excuse.'"

Appellee has not urged ratification because he believes there can be no doubt but what the contract was properly authorized and executed. However, there would seem to be little doubt too, that if ratification can occur, it did occur here.

VI.

Statute of Frauds

For the first time the Appellants urge the Statute of Frauds on their appeal. It was not pleaded. It was not urged or even suggested in the trial court. It is respectfully submitted that even if the issue had merit it could not now be urged. The statute is an affirmative defense which may be waived and must be pleaded under *Section 8 (c) Federal Rules of Civil Procedure.* If not, it is lost.

See: *Ford Motor Co. v. Chas. A. Myers Mfg. Co.,* 64 F.2d 942 (6th Cir. 1933);

Oedekerk v. Muncie Gear Works, 179 F.2d 821 (7th Cir.).

The defense of the statute assumes the contract was not signed by anyone "lawfully authorized." The Trial Court found to the contra.

VII.

Failure of Performance

The attempt of the Appellants to justify the discharge of Appellee upon the facts presented in this law suit is about as weak as such an attempt could be.

There was not a single act of malfeasance charged against the plaintiff. He was never criticized by anyone as to the manner in which he handled his job until he received notice his contract "was illegal". The business showed an increase while he was there. The several directors testified that when they were in the offices of the companies they did not see him. They did not charge he was not on company business, but simply they did not see him and they were accustomed to seeing the former manager always at his desk. Several employees were brought in to testify that Held did not go to talk to them very often in their departments, but admitted

their departments were running smoothly and there was no particular need for him to do so (TR 250; 254). It would appear that they expected Held to be everything, for everybody, all the time.

The directors admitted he was never given any particular instructions in learning the manner of the operation of the business and was never told whether he was expected to spend all his time in the office or out of the office nor was any routine established or recommended. A good example of the character of criticism leveled at Held appeared in the testimony of D. O. Essley, the President who succeeded Mr. Smith. He testified Held was not the man they wanted—"nothing personal against him" (TR 205) but he wasn't in his office very much of the time. He was then asked (TR 207):

> "Q. I will ask you to state about how many times you tried to find Mr. Held there at the place of business or the plant and were unable to?
>
> A. Oh, maybe once or twice."

And for that they chose to terminate his contract!

The testimony of the field men, i.e., Herbert Holmes (TR 295-304), John Kleinz (TR 311-313) and Lehi Palmer (TR 305-309) would indicate that Held not only took a keen interest in the problems of the companies, but was willing to work on Saturdays and in the evenings, although the companies' offices were not ordinarily open on Saturday (TR 229). Although all of these witnesses were defendants' witnesses they had no complaint or criticism to offer against Mr. Held.

Pauline McInerney testified that he did not appear to be interested in the financial reports and data, and yet James Leonard, who is a CPA and was office manager, testified that he furnished financial reports and data to Held and

that Held did take an interest in the financial progress of the companies (TR 338-340). It is not without significance to point out that on one occasion when Mr. Leonard was making out a report for Held at Held's request, Mrs. McInerney inquired what he was doing and when told, she told Mr. Leonard that it was not necessary to make the report (TR 340). It would appear that Mrs. McInerney, who had been there for some 15 years was not happy at the choice of a manager from the outside.

Several witnesses testified that Held conducted staff meetings which were held at his direction and at which each department head was given the opportunity to make any suggestions he desired to make (TR 341, 250, 277). Held testified that he made it a point to visit each of the directors at his farm and get acquainted and discuss the problems of the business. The directors did not deny this. He made trips to some of the concerns with which the companies were doing business to find out if business could be increased. He learned from one director that the lubricating oil sold by the company was not being used by the director in his heavy machinery because he was afraid of its quality. Held promptly had a sample analyzed in Chicago to determine the difficulty. He attended field demonstrations of equipment being sold by the company; he went with salesmen to help work out customer relations problems; he prepared a new advertising campaign resulting in the unloading of an over-stocked inventory of tires; in short, he apparently did everything that one would ordinarily expect that a capable and experienced manager would do.

The court found that the Plaintiff and Appellee at all times complied with the terms of his contract and that the action of the corporation in terminating his employment

was wrongful and without justification (Finding of Fact VI and VII TR 30).

VIII.

Computation of Damages

The last resort of the Appellants to defeat the right of Appellee to the benefits of the contract is to contend that the term "net income" means only "net taxable income" or "net income for tax purposes" and since there was only a trifling amount of such income in one corporation and none at all in another, this contracting party can recover only $435.21.

"Net income" according to the ordinary meaning of the term is the gross income after costs and expenses have been deducted,

> "remaining after the deduction of all charges, outlay, loss, etc.; as net profit; net proceeds; net income" (Webster's New International Dictionary, Second Edition Unabridged)

"Net income" is not a word of art or phrase capable of exact or inexorable definition. With respect to depletion allowances it may mean one thing

> See: *Carter v. Phillips,* 88 Okla. 202, 212 P. 747 (1923)

with respect to Federal income taxation, another; and with respect to trust accounting still another,

> See: *Hopkins v. Austin State Bank,* 410 Ill. 67, 101 NE 2 536 (1951).

As this Court said in *Hawaii Consol. Ry. v. Borthwick,* 105 F2 286-288 (9th Cir. 1939)

> " 'Net income' is an elusive term, and often remains so despite elaborate attempts to define it."

As the court further stated in the same opinion it is ordinarily the amount remaining after deducting from the taxpayers gross income, the aggregate of all costs and expenses.

Now the Appellants would urge that after net income is computed according to the ordinary meaning of the term, the defendants' corporations can, by designating practically all of it as "net margin" practically eliminate net income altogether and thus eliminate their liability for damages. The reason the defendants designate what would ordinarily be "net income" as "net margin" is that what is left over as profit is returned to the co-op members as dividends. The only portion they designate as net income for their own corporate procedure is a nominal sum received from sales to non-members.

Actually, there is no dispute about what both parties intended. The plaintiff, Held, testified that in discussing the figures with Walmsley they were negotiating on the basis of 2% of a figure of approximately $400,000.00 per year which was the net income or net savings of the corporations (TR 97). He further testified that net savings and net income are used interchangeably in cooperative terminology (TR 97). Likewise, Walmsley admitted that it was this same figure which he had in mind and had actually discussed with Held as the basis for the percentage compensation (TR 171; 186). Nowhere in the record is there a single word of evidence or even a suggestion that the parties contemplated the percentage figure to be applied to the taxable income. Walmsley also testified that this figure of approximately $400,000.00 was the figure which in ordinary corporate practice and parlance would be "net income" (TR 173-174).

> "Q. That figure [$4,387.20] plus $389,000—odd figure that you have just testified to would represent the

net earnings or net income or net savings for the two corporations for that period, would they not?

A. Yes, they would."

In view of the fact that Walmsley was the auditor and financial expert upon whom the directors were now supposed to be relying in order to negotiate and advise on contract terms and arrangements, it is a little surprising to learn that he is ignored for the purposes of this argument. The net income figure for tax purposes (TR 192) was so trifling in comparison with other business done that it was never considered as a factor in contract negotiations and there is no dispute in the evidence on this point. It was never mentioned by either party and considerable doubt exists as to whether Held ever had any idea that such a computation existed on the books of the two corporations.

It is well established that in considering the terms and meaning of a contract the common or usual meaning should be ascribed to the terms.

Black Star Coal Co. v. Napier, 303 Ky. 778, 199 SW2d 449 (1947);

S. S. Kresge Co. v. Sears, 87 F.2d 135, 138 (1st Cir. 1936).

In corporate management "net income" is synomymous with "net earnings" or "net profits" and means the gross proceeds of sales less the cost of merchandise and cost of sales. Walmsley frankly admitted this. In co-operative terminology those terms are used inter-changeably with "net savings" and "net margin". Orval Knox, one of the defendants' officers and directors stated that the directors were discussing the proposed compensation on the basis of authorizing Mr. Smith to negotiate with Held for a salary of $10,000.00 plus "up to 5% of the net". (TR 146). D. O.

Essley indicated the same (TR 204-205). It is apparent hey were computing the net in the ordinary significance of he term.

The primary and fundamental rule of construction in nterpreting contracts is to determine what was the in- ention of the parties and that intention should control.

See: *Tyson v. Tyson*, 61 Ariz. 329, 149 P.2d 674 (1944);

Pacific Portland Cement Co. v. Food Mach. & Chem. Corp., 178 F.2d 541 (9th Cir. 1949).

The Arizona case in discussing contracts between husband nd wife which the court had for interpretation referred to he rule of the restatement of the law of contracts and stated t page 678:

"Restatement of the Law, Contracts, Sec. 236:

"(a) An interpretation which gives a reasonable, lawful and effective meaning to all manifestations of intention is preferred to an interpretation which leaves a part of such manifestations unreasonable, unlawful or of no effect."

In the *Pacific Portland Cement Co.* case, supra, this Court tated at page 552:

"It is the aim of courts, in interpreting a written contract, to give effect to the mutual intention of the parties as it existed at the time of the execution of the contract. This is a primary rule of construction, generally recognized and embedded in California law (citing cases)

"In applying this norm, the courts will interpret words in the sense in which they are ordinarily used, except when they are used in a special or technical sense (citing cases)

"The principle has been summed up very succinctly by Judge Learned Hand in New York Trust Co. v. Island Oil & Transport Corp., 2 Cir., 34 F.2d 655, 656:

> "'It is quite true that contracts depend upon the meaning which the law imputes to the utterances, not upon what the parties actually intended; but, in ascertaining what meaning to impute, the circumstances in which the words are used is always relevant and usually indispensable. The standard is what a normally constituted person would have understood them to mean, when used in their actual setting.'
>
> "In seeking light on the meaning of words used in a contract, prior negotiations and surrounding circumstances may be considered * * *"

Here the intention has been established without contradiction and the Court has rendered its judgment in accordance with that established intent.

In order to adopt the construction the Appellants have urged it would be necessary not only to disregard the uncontradicted intent of *both* parties, but it also becomes necessary to adopt a contruction which would be unreasonable and unjust. Such an interpretation does not become the law and is not established by precedent. On the contrary, a construction is to be avoided which would lead to absurd or unjust results.

See: *Berkal v. M. De Matteo Const. Co.,* 327 Mass. 329, 98 N.E.2d 617 (1950);

Mead v. Seaboard Surety Co., 198 Minn. 476, 270 N.W. 563 (1936);

Wisconsin Employment Rel. Bd. v. Gateway Glass Co., Inc., 265 Wisc. 114, 60 N.W.2d 768 (1953);

Nevada Half Moon Mining Co. v. Combined Metals R. Co., 176 F.2d 73 (10th Cir. 1949);

Kuenzi v. Radloff, 253 Wisc. 575, 34 N.W.2d 798 (1948).

In the *Berkal* case, supra, the Supreme Judicial Court of Massachusetts said at page 620 with relation to the construction of a contract,

> "So far as reasonably practicable it should be given a construction which will make it a rational business instrument and will effectuate what appears to have been the intention of the parties."

The Wisconsin Supreme Court in the *Wisconsin Employment Rel. Bd.* case, supra, significantly said at page 770:

> "Under recognized rules of interpretation of contracts where one construction would make a contract unusual and extraordinary while another equally consistent with the language used would make it reasonable, just and fair, the latter must prevail."

In the *Nevada Half Moon Mining* case, supra, the Circuit Court for the 10th Circuit had for consideration upon appeal the question of the application of an agreed percentage figure to certain net mill or smelter returns of the sale of ores. The trial court failed to include in the figure to which the percentage was to be applied, the proceeds of certain premium or subsidy payments of the Metals Reserve Company, a wholly owned agency of the United States. The Appellant contended the percentage should be applied to these payments as well as to the net smelter returns. The Court agreed. The Circuit Court stated at page 75:

> "The cold language contained in a written agreement, standing alone, is not always controlling. General Finance Corp. v. Dillon, 10th Cir. 172 F. 2d 924. That which is necessarily implied in a contract is as much a part of it as though expressly stated therein, but the implication must result from the language employed in the instrument and be indispensable to carry the intention of the parties into effect. If it is clear from all the pertinent parts or provisions of the contract

> taken together and considered in the light of the facts and circumstances surrounding the parties at the time of its execution, that the obligation in question was within the contemplation of the parties, or was necessary to carry their intention into effect, it will be implied and enforced. Sacramento Nav. Co. v. Salz, 273 U.S. 326, 47 S.Ct. 368, 71 L.Ed. 663. And a contract should not be so narrowly or technically interpreted as to frustrate its obvious design or so loosely construed as to relieve a party of an obligation or liability fairly within its scope or spirit."

In *Kuenzi v. Radloff*, supra, the question for consideration was a contract by which an engineer was to be compensated on the basis of a percentage of the "estimated value" of a certain project. The defendants insisted that the value should be the market value of the property which was very low rather than the estimated cost value as testified to by the plaintiff. The plaintiff contended that such would lead to an unjust and unusual result. Said the court at page 802:

> "It is considered that this case is ruled by Burroughs v. Joint School District, 155 Wisc. 426, 144 N.W. 977. It was there held that if when the term 'value' is applied to a particular contract, or conditions growing out of it, it leads to results clearly not contemplated by the contract read as a whole, and it is susceptible of another meaning which harmonizes with all the provisions of the contract, such other meaning should be given to it. * * *"

If, by the simple expedient of classifying "net income" by some other name the Appellants can defeat Appellee's recovery, the Appellee's rights are fleeting indeed. A change in designation cannot alter the essential character of an item. The point is that both parties had contracted on the

basis of a certain percentage of the "net" from operations. They both understood this. They both admitted this in their testimony. There is no dispute about it. Now, it appears that by their manner of classification or by their handling of their inter-corporate affairs the Appellants had arranged it so that Southwest had no income at all of its own. Certainly the parties were not contracting on a basis of 2% of nothing. By the same token, the Appellants had arranged their accounting with United so that the net income of that corporation for one year (1952) was only $21,000.00 and they would therefore say that the limit of their liability is the agreed percentage of this sum for one year, or the sum of $435.21. A contract entered into by business men should receive an interpretation that would be in accord with common sense and reasonable business practices.

Classification of business accounts on the books for accounting purposes are as varied as the accountant's imagination and the needs of the party's business. It should not be used as a subterfuge to defeat a recovery to which a litigant is fairly entitled.

IX.

The Findings of the Trial Court Should Be Sustained

It is a familiar rule of Appellate practice that where there is a conflict in the evidence it is the duty of the trial court who has observed the witnesses and listened to the testimony, to appraise all of the facts, and his findings are conclusive where there is substantial evidence to support them (Federal Rules of Civil Procedure, 52 (a) 28 U.S.C.A.).

See: *Carr v. Yokohama Specie Bank,* 200 F.2d 251 (9th Cir. 1952);

Pacific Portland Cement Co. v. Food Mach. & Chem. Corp., 178 F.2d 541 (9th Cir. 1949).

As has already been pointed out under the argument upon particular points involved, there is substantial evidence on the agency question that Smith and Smith alone was the one whom the boards of directors empowered to negotiate the contract and execute it on behalf of the corporation. The trial court so found on this evidence. There was also substantial evidence of apparent authority and the trial court's judgment was in accord with this evidence. Likewise, on the question of whether or not there was a failure of performance, there was substantial evidence in favor of the court's findings in favor of Plaintiff and Appellee; and finally, upon the question of damages the evidence appears to be uncontradicted.

SUMMARY OF ARGUMENT

The Appellee has answered the argument of the Appellants point by point.

It is submitted that a provision in the By-Laws of a corporation for employment "at the pleasure" of the Board, does not permit the Board to remove without cause, where there is a contract for a definite term and that furthermore, where there is the power in the board to amend by-laws, the hiring for a term amounts to such an amendment. For both reasons the contract of employment is valid. Each corporation has the right to amend its By-Laws and that power was in fact exercised from time to time. The Arizona statutes do not circumscribe that power. Only one corporation was organized pursuant to the Co-operative Marketing Act and there was no limitation by way of any "contract period", upon that right to amend by-laws.

The contract was not invalid because it exceeded the term of office of the Board because there is no public policy holding that such a contract is invalid. Furthermore, the con-

tract here was for a term of three years and the term of office of each member is three years. The fact that the Board was set up on a basis of staggered terms is not significant because the facts disclose the members have been by custom re-elected for successive terms until death or retirement.

The Appellee contends that the contract which was signed by Walter Smith, President of both corporations, was expressly authorized and that Smith as agent was expressly authorized. In addition the Appellee contends that the President had apparent authority to sign and that the contract was ratified.

The finding of the trial court that there was no failure of performance and that the Appellee was discharged arbitrarily and without cause, is abundantly supported by the evidence.

Finally, it is pointed out that the parties contracted on the basis of 2% of the net income as ordinarily understood and where, as here, the accounting records of Appellants show part of that income as "net margin" to distinguish it from "taxable income", the plaintiff is entitled to recover on the basis of 2% of all net proceeds because that was the intention, as testified to by both Appellants' witnesses and by Appellee. "Net income", "net proceeds" and "net margin" are synonymous terms in co-operative terminology.

CONCLUSION

It is submitted that the case was fairly and carefully tried and the judgment of the District Court should be affirmed.

Respectfully submitted,

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